THIS MONTH

THE LATEST ON IFRS

The treasury world is changing rapidly and keeping up to date with the numerous regulatory, accounting and market changes can be quite a challenge. Today's rules on accounting for derivatives don't at all resemble how we used to 'account' for them when I began my treasury career many moons ago and they are still changing. I've tried to take stock of where I believe we are, for both IFRS and UK GAAP in the article below.

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{ IN DEPTH }

ACCOUNTING FOR FINANCIAL INSTRUMENTS

Progress of IFRS 9, *Financial Instruments*

The IASB's project to replace IAS 39, *Financial Instruments: Recognition and Measurement* is ongoing. In late November 2012, the IASB issued a new exposure draft, *Classification and Measurement: Limited Amendments to IFRS 9*. The proposed amendments are narrow in scope and consistent with the existing principles in IFRS 9, *Financial Instruments*. One significant change is a new third measurement category for debt instruments: fair value through other comprehensive income (FVOCI). The exposure draft is open for comment until 28 March 2013.

Hedge accounting

In September 2012, a review draft of the forthcoming IFRS 9 hedge accounting requirements was published by the IASB. The ACT responded, highlighting a fatal flaw: the treatment of currency basis risk in cash flow hedges. The review draft specifically excluded currency basis risk from the value of a hypothetical derivative used to calculate the change in the value of the hedge item. This would have resulted in profit and loss volatility because the actual derivative (ie the hedging instrument) incorporates a currency basis spread that cannot be avoided. At its January board meeting the IASB accepted that currency basis reflects a 'cost of hedging' in forward FX pricing, similar to premiums paid for options. This is a win for corporates, but the solution does increase the administrative burden in calculating and accounting for the cost of the hedge.

Implementation of IFRS 13

IFRS 13, *Fair Value Measurement* is effective for periods commencing on or after 1 January 2013. Where accounting standards require or permit transactions or balances to be measured at fair value, the definition has changed from the price it could be 'settled' with the counterparty to the value at which a liability could be 'transferred' (the so-called 'exit' price). IFRS 13 also clarifies that the fair value of a financial liability would be equal in amount to the same instrument held as an asset. This means that an entity's intention to settle is no longer an argument to justify not making credit adjustments to fair values of derivative liabilities. This change will only be relevant to IFRS reporting entities, as there is no corresponding amendment to FRS 26, *Financial Instruments: Recognition and Measurement*.

UK GAAP

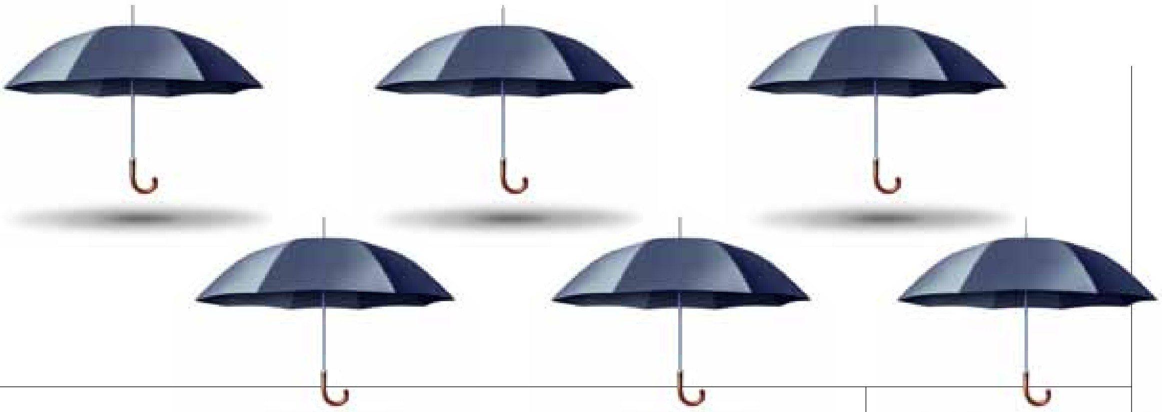
The Financial Reporting Council has issued FRS 100, *Application of Financial Reporting Requirements* and FRS 101, *Reduced Disclosure Framework*, with FRS 102, *The Financial Reporting Standard* expected soon. These three new standards, effective 1 January 2015, require all entities to recognise derivatives at fair value on their balance sheet. They will no longer be able to just disclose their fair value in the notes to the accounts.

FRS 100 entities that are not required to apply the IFRS, and which are too small to use the Financial Reporting Standard for Smaller Entities (FRSSE) have three options:

- To voluntarily apply the IFRSs;
- To apply FRS 102, the replacement for existing UK GAAP (based on IFRS principles); and
- To apply, subject to certain conditions, FRS 101, a version of IFRSs with reduced disclosures.

YOUR SHOUT

The ACT plans to respond to the Financial Reporting Council's consultation on implementation of the Sharman Panel recommendations on going concern and liquidity risks before the deadline of 28 April 2013. Email: technical@treasurers.org



{ INTERNATIONAL }

MORE CONSULTATION ON MMFS

Previously, we noted that the International Organization of Securities Commissions had published its final report on policy recommendations for Money Market Funds (MMFs). (See page 11 of *The Treasurer*, December 2012/January 2013.) The recommendations included a variety of possible protections for funds. The ACT argued that the constant net asset value (CNAV) label can be misleading since maintaining par value is not guaranteed, but converting CNAV funds to variable net asset value (VNAV) would cause many companies to stop using them. For the complete ACT response, see www.treasurers.org/node/7957

The US Financial Stability Oversight Council (FSOC) is also consulting on MMFs. Its proposals would introduce a significant change to the character of the MMF market and may set the precedent for Europe since the European Commission is also considering reforms. The FSOC's proposals are:

- Alternative 1: floating net asset value (NAV) – requires MMFs to have a variable NAV per share by removing the special exemption that currently allows MMFs to use amortised cost accounting and/or penny rounding to maintain a constant NAV.
- Alternative 2: constant NAV with NAV buffer and 'minimum balance at risk' – requires MMFs to have an NAV buffer with a tailored amount of assets of up to 1% to absorb day-to-day fluctuations in the value of the funds' portfolio securities and allow the funds to maintain a constant NAV.
- Alternative 3: constant NAV with NAV buffer and other measures. Requires MMFs to have a risk-based NAV buffer of 3% to provide explicit loss-absorption capacity that could be combined with other measures to enhance the effectiveness of the buffer and potentially increase the resiliency of MMFs.

NEW ON THE WEB

View the following technical updates and policy submissions at www.treasurers.org/technical

ACT response to FSOC on money market reforms

ACT response to HMRC on a General Anti-Abuse Rule

Briefing note on Libor alternatives

Briefing note on OTC derivatives: implications for non-financial companies

{ WATCH THIS SPACE }

FTT IMPACT WILL BE FELT BEYOND THE ZONE

The new EU financial transaction tax (FTT) is to be implemented across France, Germany and nine other EU member states (collectively referred to as the FTT Zone).

Branches of banks in the zone will be subject to the tax, so the London branch of a French bank will have to pay FTT on all its securities and derivatives business. Additionally, financial institutions based outside the zone will be taxed whenever they transact with parties in the zone or deal in securities issued by an entity established there. Transactions cleared through clearing systems in the zone may also get caught, which could result in all transactions cleared through Euroclear (Belgium) being taxed.

The definition of 'financial institution' is wide and includes insurance companies and pension funds. Meanwhile, the 'cascade effect' of taxing each intermediary party in a transaction (ie brokers and clearing members, but not the clearing house) will result in an effective rate closer to 1% than the 10bps headline rate.

This raises two questions: will businesses and funds relocate to avoid FTT? And, what will be the knock-on impact cost of hedging for corporates?

{ TECHNICAL ROUND-UP }

INTERNET SECURITY, PENSIONS AND FATCA

The European Central Bank (ECB) has released its final version of *Recommendations for the security of internet payments*, after public consultation in 2012. The 14 recommendations establish minimum expectations that payment service providers, banks and credit card companies must implement by 1 February 2015. Other market participants, such as e-merchants, are encouraged to adopt some of the best practices. The full list of recommendations can be found at tinyurl.com/cmqwsmd

The Department for Work and Pensions has issued a call for evidence on pensions. The topic is whether to allow companies with defined benefit schemes undergoing valuation in 2013 or later to 'smooth asset and liability values', ie apply average asset prices and discount rates over a longer period of time, instead of using current market spot rates. The responses would form the basis of the options to be further consulted on. The call for evidence closes on 7 March 2013. Visit www.dwp.gov.uk/docs/pensions-and-growth-call-for-evidence.pdf

The US has issued the final Foreign Account Tax Compliance Act (FATCA) regulations. FATCA is a punitive 30% withholding tax that foreign financial institutions (FFIs) must pay on payments derived from US sources if they don't agree to disclose US account holders. The final regulations have clarified that holding companies, treasury centres and captive finance companies of a non-financial group are not FFIs. But these exemptions do not apply where these companies are established by private equity funds.

The Institute of Chartered Secretaries and Administrators has issued new guidance on the liability of non-executive directors (NEDs). The guidance note includes advice to NEDs on what due diligence they should undertake before joining a board and on appointment to a board. A copy of the guidance note can be found at tinyurl.com/a3jvb4d